Supreme Court of the United States

OCTOBER TERM, 1943

No. 930

MELVIN HYMAN, as Trustee in Bankruptcy of Joseph Benjamin Lane, and JOSEPH BENJAMIN LANE, Petitioners,

vs.

R. W. McLENDON, W. E. McLENDON, and C. E. McLENDON, Respondents.

REPLY BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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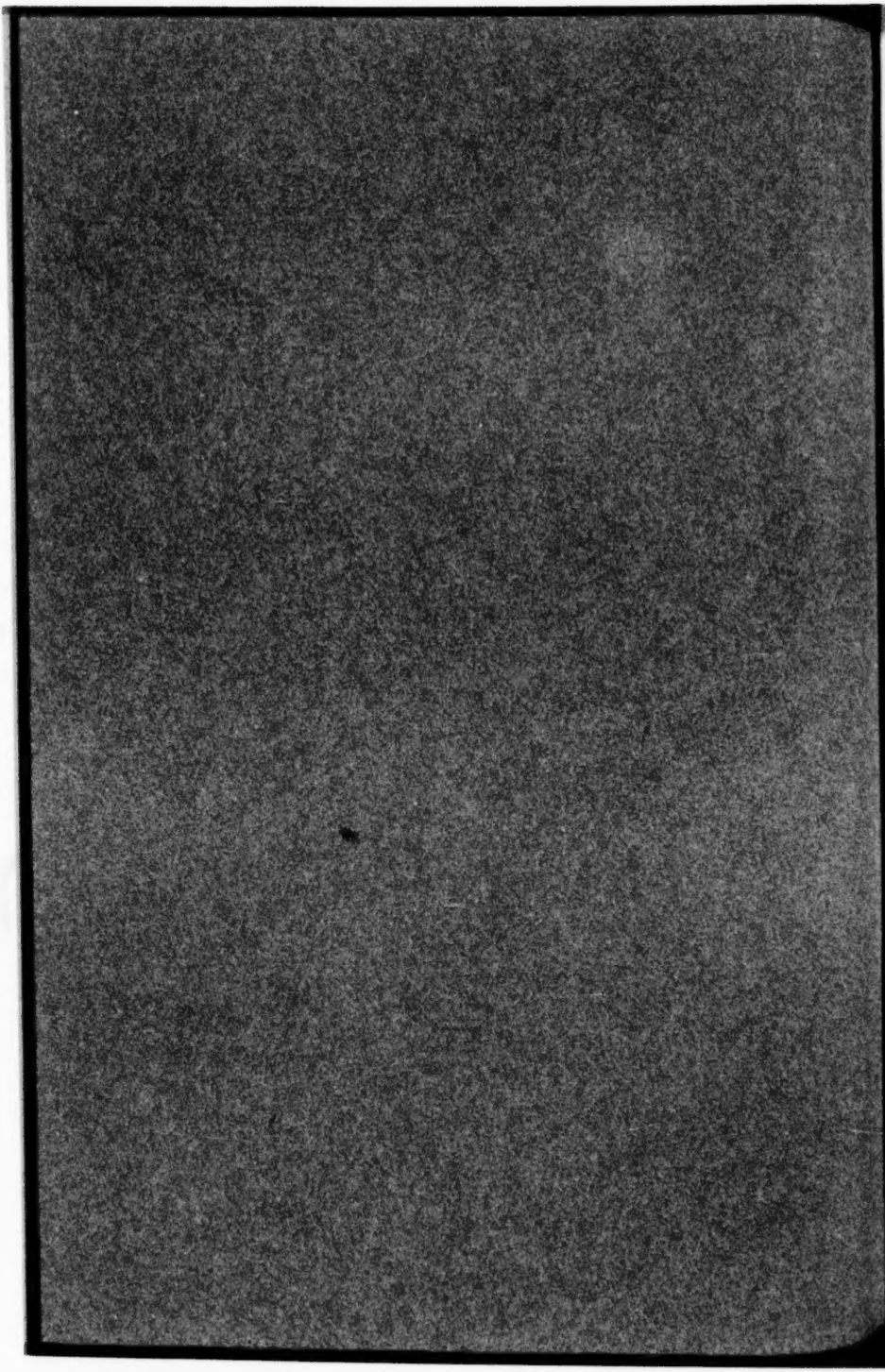

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No. 830

MELVIN HYMAN, AS TRUSTEE IN BANKRUPTCY OF JOSEPH BENJAMIN LANE, AND JOSEPH BENJAMIN LANE, PETITIONERS,

versus

R. W. McLENDON, W. E. McLENDON, AND C. E. McLENDON, RESPONDENTS

REPLY BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

I

THE FACTS

The facts involved in the present controversy are fully stated in an able report made by the Special Master (R., 47). The findings of fact made by the Special Master are concurred in by the District Judge (p. 83), and are adopted by the Circuit Court of Appeals (R., 95).

As far as material to the matter before this Court, the facts are as follows: Starting in 1922, there had been many dealings between Lane and the Messrs. McLendon, as the result of which Lane claims that the Messrs. McLendon

have in their names certain valuable real estate to which he is entitled, and that they are liable to him for moneys had and received and for damages sustained by him to the extent of $85,000.00. As the result of the various transactions between the parties Lane had brought certain suits against the Messrs. McLendon, seeking largely the same recoveries which are sought in the present litigation (R., 52, 53, 59). There were also legal proceedings on the part of the McLendons against Lane involving some of the transactions now in issue (R. 49, 51). As the result of the litigation in question the parties in 1932 entered into a settlement agreement, under the terms of which adjudications were made in the state court adjusting the respective rights and liabilities of the parties (pp. 54-56). As the Circuit Court of Appeals says:

> "The settlement disposed of all the matters in controversy between the parties, including those here in litigations" (R., 102).

On September 24th, 1935, Lane filed his bankruptcy petition disclosing no assets available for the payment of his debts, and showing total indebtedness amounting to slightly over $24,000.00 (R., 57). The bankruptcy court did not appoint a trustee, and on October 28th, 1935, the bankrupt filed a petition for his discharge. In this petition (General Orders in Bankruptcy, Form No. 41) Lane alleged under oath that he had made a full disclosure to the bankruptcy court of all of his assets and liabilities, just as he had previously done in his schedules (General Orders in Bankruptcy, Form No. 1).

On January 20th, 1936, an order discharging Lane in bankruptcy was granted.

On May 7th, 1936, Lane instituted in the Court of Common Pleas of Lee County, South Carolina, the action which is the subject-matter of the present litigation (R., 57). In this action Lane asserted that a certain tract of land of 127

acres, formerly owned by him, and which had been acquired by one of the McLendons in foreclosure proceedings under a mortgage made by Lane to a bank, was in fact his and that he was entitled to have the title conveyed to him free of all encumbrances thereon. In the same suit Lane demanded damages in the amount of $85,000.00 based upon various alleged financial transactions in connection with which he claims to have placed money in the hands of R. W. McLendon, and to have sustained damages as the result of the handling of certain of his lands by the McLendons. The transactions involved in the allegations in this suit began in 1922 (R., 47).

There being nothing before the bankruptcy court at the time of the institution of this action, it was of course necessary for the McLendons to answer in the state court to protect their rights. This they did, setting up in their answer, however, certain special defenses calling attention to the failure of Lane to disclose the resources in question in his bankruptcy proceeding, and setting forth that title to such assets rested in the bankruptcy court alone, and that Lane was not entitled to prosecute any suit respecting the same (see *infra*, IIIc).

On July 3rd, 1936, the Messrs. McLendon filed a petition in the bankruptcy cause submitting themselves to the jurisdiction of the bankruptcy court, alleging that the bankrupt had obtained his discharge by fraudulent concealment of his assets, and praying that the discharge previously granted be revoked, and that the bankruptcy cause be reinstated and fully administered in the bankruptcy court. On this petition the court adjudged that Joseph Benjamin Lane had been guilty of fraudulent concealment of his assets, and that his discharge had been fraudulently obtained. It was thereupon ordered by the court that the discharge previously granted be revoked, that the cause be reinstated,

and that a trustee be appointed with power to enforce and have the benefit of such claims as the bankrupt was making in the state court (R., 58).

A trustee was thereupon appointed by the bankruptcy court (*ibid.*).

On or about March 25th, 1938, the McLendons filed a petition in the bankruptcy court setting forth the attempt of Lane to continue the prosecution of the action in the state court, submitting themselves to the jurisdiction of the federal court in respect to all of the matters in question, and praying a decree adjudicating "the rights and relations of the petitioners and the respondent respecting all of the matters in dispute and the controversies existing between them as set forth in this petition" (R., 58). The matters set forth in the petition are admittedly the identical matters which were set forth by Lane in his action in the state court (R., 59, *et seq.*).

On this petition the bankruptcy court "abated" the state court action (R., 40); more accurately, it simply accepted the submission of the McLendons to the jurisdiction of the bankruptcy court; it further restrained the continued prosecution of the state court suit and directed that all of the matters in issue be tried in the bankruptcy court. A special master was appointed to take the testimony of the parties.

It will be observed that the fundamental issues presented by the McLendons as controlling the claims of Lane were that all of the matters in controversy had been settled by specific adjudications made in decrees of the Court of Common Pleas of Lee County, South Carolina (R., 61-62), and that as a result of such decrees, and also independently thereof, both Lane and the Trustee were estopped to assert the claims in question.

It was upon this state of the record that the following material findings and decrees were made in the present cause:

(1) The Special Master concluded that Lane is estopped to maintain the litigation, but that this estoppel does not bind the Trustee; also that the doctrine of *res judicata* does not bar the prosecution of the action on behalf of the Trustee, solely for the benefit of the creditors of Lane (R., 76).

(2) The District Judge concurred in all of the findings of fact of the Special Master; he also concurred in the conclusion that Lane is estopped to prosecute his claims; he held however that under the doctrine of *res judicata* neither Lane nor the Trustee may recover on any of the asserted causes of action. The District Judge makes the additional legal finding that the trustee in bankruptcy "has failed to substantiate his claims" against the McLendons. He disallowed and dismissed all of the claims (R., 83-84).

(3) The Circuit Court of Appeals affirmed the decree of the District Judge. It went a step further to show that the result of the litigation has been to disclose that there is no longer anything substantial in the controversy between the parties, because the McLendons directly or indirectly own and control the greater part of the claims of the creditors of Lane (see *infra*, II).

II

MERITS OF CASE HAVE BECOME MOOT

The sole question presented by the petition relates to the jurisdiction of the District Court sitting in bankruptcy to adjudicate the question whether the Messrs. McLendons had in their hands assets belonging to the bankrupt, and whether they were accountable to him by way of damages

for moneys withheld and on account of their handling of certain transactions for the bankrupt.

Will this Court go into the jurisdictional issue when, as clearly appears from the record, it has been definitely and finally adjudicated that the prosecution of the Lane claims, both by the Trustee and by Lane himself, is barred under the doctrine of *res judicata* (which is the equivalent of saying that said claims are legally non-existent)?

Even if a jurisdictional question is presented, the litigation involves problems that have become moot. The stated object of the litigation in the first instance was to recover for Lane (exclusively) a tract of 127 acres, and 85,000.00 in damages and by way of accounting. After the Trustee in bankruptcy was appointed the stated object of the litigation then was to recover these resources first for the benefit of the creditors of Lane, and, to the extent of the excess, for the benefit of Lane.

The Special Master concluded that the claims could not be prosecuted for the benefit of Lane individually, because he was estopped in equity to assert the claims made by him, but that the cause could be prosecuted to a conclusion by the Trustee in bankruptcy to the extent solely of the interests of the bankrupt's creditors. The District Judge concurred in the findings of fact and conclusions of law of the Special Master to the extent that Lane was personally denied any right of recovery; he however concluded that the bar of the defense of *res judicata* is applicable to the Trustee in bankruptcy and to Lane alike, and that accordingly no recovery on the merits may be had in the present litigation by either.

There being no appeal from the decree of the Circuit Court of Appeals substaining the District Court on the merits, the present status is that if a writ of certiorari is granted on the sole ground upon which the application is

based, to wit, the jurisdiction of the federal court, and if this Court were to conclude that the federal court is without jurisdiction of the controversy, the result would be that the Trustee would be in the position of having to proceed with litigation in the state court in the face of a final ruling in the federal court that neither he nor the bankrupt has any rights in the premises, or he would have to abandon the litigation entirely.

Passing that anomalous phase of the matter, however, the fact that the matters in controversy have become strictly moot is shown by the finding of the United States Circuit Court of Appeals to that effect. It will be observed that after stating its conclusion "that the trustee in bankruptcy is precluded from recovery by the settlement which is binding upon Lane", the Court says:

> "The point last discussed has not been stressed in the briefs of counsel, possibly because, as we understand from the argument, the greater portion of the debts listed by the bankrupt are owing to the McLendons or to corporations owned or controlled by them and there would be little advantage or disadvantage to anyone from a recovery by the trustee accruing solely to the benefit of these creditors. The real controversy here is between Lane and the McLendons and it has been so presented. As stated above, we think that Lane was clearly bound by the settlement embodied in the court orders of February, 1933, and the trustee is in no better situation. If he were, the matter would have little practical significance, since the estoppel against Lane would mean that, as a practical matter, recovery by the trustee would be limited to the amount of the bankrupt's debts and would be returned to those from whom recovery was made or to corporations controlled by them (R., 104-5).

In other words, the present object of the litigation, whether taken to be a recovery for the benefit of Lane alone or for the Trustee in bankruptcy alone or for the benefit of

both is destroyed by the concurrent conclusions of the Special Master, the District Judge, and the United States Circuit Court of Appeals that there can be no recovery on behalf of Lane, and by the concurrent conclusions of the District Court and of the Circuit Court of Appeals that there can be no recovery on behalf of the Trustee in bankruptcy. If a recovery were had by the Trustee in bankruptcy it would operate, as the Court of Appeals says, principally for the benefit of the respondents "and there would be little advantage or disadvantage to anyone from a recovery by the trustee accruing solely to the benefit of these creditors."

In short, at this stage of the litigation as appears from this statement of the Circuit Court of Appeals, there is no longer any real controversy between the parties for the reason that the McLendons own or control the claims that would be benefited if the litigation were to continue. The case therefore comes within the decision of this Court in *Chamberlain v. Cleveland,* 1 Black, 419, 17 L. Ed., 93. In that case the litigation between the parties amounted to an actual controversy and was prosecuted with vigor and in good faith until a decree was rendered by the lower court in favor of the plaintiff. After this happened the defendant became the owner of the plaintiff's judgment and, as this Court said, the real actor in the litigation on both sides thereof. In this state of facts the Court said that the defendant having become the sole party in interest on both sides of the controversy the case became moot and could not be entertained. The Court held that the case was controlled by the principle decided in *Lord v. Veazie,* 8 Howard, 251, 12 L. Ed., 1067, even though that case originated in collusion and was never prosecuted in good faith.

In the case of *American Wood Paper Company v. Heft,* 8 Wallace, 333, 19 L. Ed., 379, this Court held that where

a plaintiff owns both sides of the litigation the case cannot be heard by this Court as the litigation is no longer real.

Other decisions of this Court to the same effect are:

Hatfield v. King, 184 U. S., 162, 46 L. Ed., 481;

California v. San Pablo, etc., R. Co., 149 U. S., 308, 37 L. Ed., 747;

United States v. Hamburg, etc., Co., 239 U. S., 466, 60 L. Ed., 387.

An excellent state case on the same proposition is *Harp v. Abbeville, etc., Company*, 33 S. E. (Ga.), 998 which was decided on the authority of the decisions of this Court.

III

JURISDICTION OF BANKRUPTCY COURT

(a) General Considerations

Relating the question of jurisdiction to a résumé of the undisputed facts, the petitioners contend that a court of bankruptcy was without jurisdiction in the following situation:

> In 1936 a debtor obtained his discharge in bankruptcy on schedules and on a petition in which he showed under oath that he had no assets available for the payment of his debts, which were substantial in amount. No trustee was appointed in the bankruptcy proceeding. Within a few months after obtaining his discharge he brought an action in the state court in which he disclosed his alleged ownership of a valuable tract of land and of large sums of money held by one or more of the defendants under a trust *ex maleficio*, and of a right of action for a large amount of damages for mismanagement of his affairs, none of which assets or rights or claims were disclosed in the bankruptcy proceedings.
>
> With the state court action pending the defendants therein (who in addition to being charged with the

possession of the bankrupt's property, are creditors of the bankrupt) petitioned the bankruptcy court to take jurisdiction of the situation and, because of the bankrupt's fraud, to revoke the bankruptcy discharged. The discharge was revoked.

The defendants in the state court action then again petitioned the bankruptcy court, this time to adjudicate the issues respecting the lands and moneys claimed by the bankrupt in the state court action, and to stay the further prosecution of the state court action. This petition was granted. A trial on the merits was held before a special master. On the facts so adduced, the District Court and the Circuit Court of Appeals ruled that under the doctrines of estoppel and *res judicata,* the bankrupt had and has no such assets or claims as are set forth in the state court action and in the proceeding in the bankruptcy court.

In determining whether the bankruptcy Court had jurisdiction it is of course wholly immaterial whether the District Judge was correct in holding this proceeding to be a summary proceeding, rather than a plenary one, and in holding that the proceeding is maintainable under the Declaratory Judgment Act, if the fact be that the proceeding is maintainable on any other legal basis. We are dealing with the question of the correctness of the holding of the District Judge that the bankruptcy Court has jurisdiction, and not with the question whether the reasons given by him for so holding are the correct reasons.

If we assume first that the proceeding is maintainable only as a plenary proceeding, the record discloses that all of the requisites of a plenary proceeding are present. The many cases on this subject are compiled by Remington, Vol. V (4th Ed.), Sec. 2134. The characteristics of a plenary suit, as the author shows, are the service of process, the formulation and joinder of issues by pleadings, and the holding of a trial in accordance with the usual forms of procedure. Here all of such requisites are present. The ap-

appellants have been properly brought before the Court by a summons served with an appropriate pleading; while challenging the jurisdiction of the Court, they were given and exercised the right to go into a full presentation of their claims in a formal trial; and the trial was conducted in strict accordance with the procedure of a cause in equity.

But that phase of the problem is hardly material. As the Circuit Court of appeals held on a prior appeal in the present litigation (102 Fed. (2d), 189) the order of the District Judge assuming jurisdiction "was made in the bankruptcy proceedings, was entitled therein, and directed the trustee as to the conduct of litigation for the benefit of the bankruptcy estate".

It was certainly within the power of the bankruptcy Court to direct the trustee, its officer, as to the manner and form in which he should proceed to recover for the bankrupt estate the large amount of assets which, according to the bankrupt, was available to be collected and administered by the trustee.

The rule is thus stated in 8 C. J., page 1021:

> "A trustee in bankruptcy is an officer of the court, and as such he is subject, in his actions in connection with the administration of the estate, to the control of the court. He must keep the court fully and frequently advised of his actions as trustee and can in important matters act only with the approval of the court."

As stated in *Pearson v. Higgins,* 34 Fed. (2), 27 (C. C. A., 9th); Cert. denied, 280 U. S., 593, 74 L. Ed., 641:

> "The trustee is an officer of the court, as fully under its control as would be a receiver."

In *Imperial Assurance Co. v. Livingston,* 49 Fed. (2d), 745-749 (C. C. A., 8th), the Court said:

> "* * * The receiver and the trustee are officers of the court for the purposes of handling such prop-

> erty in accordance with the directions of the court within the Act. * * * "

As applied to the maintenance of suits by a trustee, the rule stated is confirmed by Section 29 (C), Title 11, U. S. C. A., where it is provided that "A receiver or trustee may, *with the approval of the court,* be permitted to prosecute as receiver or trustee any suit commenced by the bankrupt prior to the adjudication, with like force and effect as though it had been commenced by him." (Emphasis added.)

In 2 Rem. on Bankr. (4 ed.), page 668, the rule is stated as follows:

> "The trustee as an officer of the court is subject to the summary jurisdiction of the court. As an officer he is subject to the court's direction in all matters concerning property or money which come into his possession by virtue of his office."

This conclusion clearly follows from the pertinent statutory directions governing the administration of a bankrupt estate by the trustee. For example, although the trustee is nominated by the creditors he is appointed by the court under statutory restrictions to prevent a monopoly of appointments within a given district (U. S. C. A., Title 11, Sec. 76(a); 202(d). If the creditors fail to nominate, the court makes its own appointment (*Ibid.*, Sec. 72). The amount of the trustee's bond (*Ibid.*, Sec. 78(c)), and the amount of his compensation (*Ibid.*, Sec. 76(a); 76(c)) are fixed by the court. In the management of the estate he at all times acts "under the direction of the court" (*Ibid.*, Sec. 75(a); Sec. 49).

If the proceeding is held to be a summary proceeding, the petitioners apparently concede that the procedure adopted is unexceptionable, and in fact goes far beyond the requirements of the situation.

The distinction between a plenary proceeding and a summary proceeding, as deduced from the great many

cases dealing with the subject, is thus stated in *Babbitt v. Dutcher*, 216 U. S., 102, 54 L. Ed., 402, 30 S. Ct., 372, 23 A. B. R., 519:

> "There are two classes of cases arising under the Act of 1898 and controlled by different principles. The first class is where there is a claim of adverse title to property of the bankrupt, based upon a transfer antedating the bankruptcy. The other class is where there is no claim of adverse title based on any transfer prior to the bankruptcy, but where the property is in the physical possession of a third party or of an agent of the bankrupt, or of an officer of a bankrupt corporation; who refuses to deliver it to the trustee in bankruptcy. In the former class of cases a plenary suit must be brought, either at law or in equity, by the trustee, in which the adverse claim of title can be tried and adjudicated. In the latter case it is not necessary to bring a plenary suit, but the bankruptcy court may act summarily and may make an order in a summary proceeding for the delivery of the property to the trustee, without the formality of a formal litigation."

While the matter is in no way controlling of the issue before the Court, there are factors connected with the handling of the litigation on behalf of the petitioners, even in the present phase of the proceedings, that are wholly inconsistent with the spirit of the bankruptcy law and of the established practice in bankruptcy courts. We let the following facts speak for themselves:

As correctly stated in petitioner's brief, the District Judge, under date of December 17th, 1937 (R., 42), authorized and empowered the Trustee to employ Messrs. Royall and Wright, together with L. D. Jennings and C. B. Ruffin, as his attorneys to pursue the matters involved in the present litigation. Of the attorneys so appointed C. B. Ruffin was the attorney of record in the original bankruptcy proceeding.

The same attorney and L. D. Jennings (now deceased) are the attorneys who instituted the suit in the Court of Common Pleas for Lee County. Mr. Seabrook came into the case after the state court suit was stayed and is actively representing and defending the conduct of the bankrupt, as well as nominally representing the trustee. The firm of Messrs. Royall and Wright have never appeared before the Court at any stage of the litigation, except to the extent that they signed their names or permitted their names to be signed to the various pleadings filed during the progress of the cause.

That the litigation has been conducted on behalf of the bankrupt and the trustee solely, by the bankrupt's attorneys, and solely for the personal benefit of the bankrupt, is an inescapable fact. Without qualification it might properly be said that as far as the intent and purposes of the bankruptcy law are concerned, the whole of the litigation, starting with the institution by Lane of his bankruptcy proceeding, has constituted the grossest kind of mockery and indeed defiance of the bankruptcy court just as, on the merits, his disregard of the several proceedings in the state court which constitute a bar to the prosecution of the litigation in any court shows a comparable attitude of cynicism and indifference.

What the petitioners are really complaining about is that they have been denied the right to prosecute to a final conclusion in the state court a concealed cause of action which should have been brought into the bankruptcy court to be there dealt with free of all contamination with the purposes that have actuated the bankrupt at every stage of the litigation.

(b) Consent of Adverse Claimants

The applicable statutory provision (U. S. C. A., Title 11, Sec. 46) is as follows:

> "Section 46. JURISDICTION; UNITED STATES AND STATE COURTS. (a) The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings in bankruptcy, between trustees as such and adverse claimants concerning the property acquired or claimed by the trustees, in the same manner and to the same extent only as though bankruptcy proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.
>
> "(b) Suits by the trustee shall only be brought or prosecuted in the courts where the bankrupt, whose estate is being administered by such trustee, might have brought or prosecuted them if proceedings in bankruptcy had not been instituted, unless by consent of the proposed defendant, except suits for the recovery of property under section 96, subdivision b, of this title; section 107, subdivision e, of this title; and section 110, subdivision e, of this title."

The exception in subdivision (b), referring to Section 110, subdivision (e), is that the trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and that the court of bankruptcy and the state court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction.

The petitioner contends that although the respondents submitted themselves to the jurisdiction of the bankruptcy court by their petition in July, 1936, and again by their petition on March 25th, 1938, and thus consented that the bankruptcy court assume jurisdiction over the claims made against them, the jurisdictional foundation had not been created under Sec. 46(b), *supra*, because the Trustee re-

sisted the proceeding in the bankruptcy court under the direction of the District Judge, instead of on his own volition. We submit that this position is without merit, and that the facts hereinbefore stated show that jurisdiction in the bankruptcy court was conferred by the concurrent consent of the respondents and the action of the Trustee acting under the Court's direction.

In the order of the District Judge made in the bankruptcy cause on September 1st, 1938 (R., 39), the Court said:

> "The actions of the McLendons in this case, beginning with the filing of their petition in July, 1936, and continuing down to the present time, clearly show that they have converted all controversies between them and the respondent, Melvin Hyman as Trustee in Bankruptcy of Lane, into a summary proceeding within the exclusive jurisdiction of this court. From this it follows that they have acquired such standing in the bankruptcy cause as to entitle them to demand as a right the adjudication by the bankruptcy court of all such controversies without any reference whatever to the Declaratory Judgment Act of Congress."

In the opinion of the Circuit Court of Appeals dismissing the petitioner's appeal from this order that Court said:

> "The order appealed from was no more than an order entered in the bankruptcy proceedings of Dr. Lane, directing the Trustee to litigate the claim against the McLendons in the court of bankruptcy, **to the jurisdiction of which the McLendons had submitted themselves,** rather than in the State court." (Emphasis added.)
>
> *Hyman v. McLendon,* 102 Fed. (2d), 189.

It thus appears that both the District Court and the Circuit Court of Appeals have held that the McLendons submitted themselves to the jurisdiction of the bankruptcy Court, and as the District Judge stated, this submission was in July, 1936.

The voluntary submission by the McLendons to the jurisdiction of the bankruptcy Court is not at all, as petitioners suggest, a one-sided affair. If, as they contend, the consent which the law contemplates imports action on behalf of the bankruptcy Court as well as on behalf of the adverse claimants, such joint action is present here. It consists of the petition of the McLendons that the Court assume exclusive jurisdiction of the matters in issue and of the order of the District Judge accepting such jurisdiction for the bankruptcy Court.

If, as contended by appellants' counsel, there must be concurrent consents of the trustee and of the adverse claimants, can it be seriously contended that the trustee's powers exceed those of the Court, and that while the trustee could consent to the assumption of jurisdiction, the Court itself is without the power to assume such jurisdiction, or to direct the trustee in respect thereto?

Every Federal case that we have been able to find holds clearly and positively that the consent of the trustee has absolutely nothing whatever to do with the question of jurisdiction. On the contrary, the right to have a controversy involving the adverse claimant or his property determined by the Federal Court of bankruptcy is a privilege that belongs to such claimant alone, and if he sees fit to submit himself and his rights to the jurisdiction of the Federal Court and ask such Court to adjudicate all controversies between him and the bankrupt, or the trustee in bankruptcy, neither of these can raise the slightest objection.

See, for example:

United States Fidelity & Guaranty Co. v. Bray, 225 U. S., 205, 56 L. Ed., 1055;

Schumacher v. Beeler, 293 U. S., 367, 79 L. Ed., 433;

Re: Hollingsworth & Whitney Co., 242 Fed., 753 (C. C. A., 1st);

Peoples National Bank v. Green, 296 Fed., 294 (C. C. A., 4th);

Re: Bennett, 285 Fed., 351 (C. C. A., 7th);

Notes Nos. 131-137, incl. U. S. C. A., Title 11, Sec. 46.

(c) Effect of Reopening Bankruptcy and Appointment of Trustee on Further Prosecution of State Court Suit

It is submitted that the fact that no trustee was appointed in the bankruptcy proceeding until after the revocation of the discharge is not a consideration affecting the jurisdiction of the bankruptcy Court. The rule undoubtedly is, as contended by petitioners, that where no trustee has been appointed, or where one has been appointed and rejects an asset consisting of a cause of action, or fails or refuses to proceed for the collection of the asset, the bankrupt has sufficient title to proceed in his own name. In this situation, however, the trustee could at any subsequent time intervene and insist upon the collection of the asset for the benefit of the bankruptcy estate.

But this rule presupposes an honest disclosure by the bankrupt of the existence of the asset. Where he fraudulently withholds from the bankruptcy Court the fact of the existence of the asset, and by that means prevents the trustee from acting, or as in this case prevents the election of a trustee, the rule has no application. This was explicitly decided in the case of *First National Bank v. Lasater*, 196 U. S., 115, 49 L. Ed., 408, where the Court said:

> "The question then presented is whether this right of action, having once passed to the trustee in bankruptcy, was retransferred to J. L. Lasater upon the termination of the bankruptcy proceedings, he having returned no assets to his trustee, and having failed to

notify him or the creditors of this claim for usury, and beginning this action within less than two months after the final discharge of the trustee. We have held that trustees in bankruptcy are not bound to accept property of an onerous or unprofitable character, and that they have a reasonable time in which to elect whether they will accept or not. If they decline to take the property, the bankrupt can assert title thereto. (Citing cases.) But that doctrine can have no application when the trustee is ignorant of the existence of the property, and has had no opportunity to make an election. It cannot be that a bankrupt, by omitting to schedule and withholding from his trustee all knowledge of certain property, can, after his estate in bankruptcy has been finally closed up, immediately thereafter assert title to the property on the ground that the trustee had never taken any action in respect to it. If the claim was of value (as certainly this claim was, according to the judgment below), it was something to which the creditors were entitled, and this bankrupt could not, by withholding knowledge of its existence, obtain a release from his debts, and still assert title to the property."

The cases upon which appellants rely on this point are clearly distinguishable. For example, in the case of *Danziger v. Smith*, 276 U. S., 542, 72 L. Ed., 691, the bankrupt had brought suit in the State Court to recover brokerage commissions claimed to be due him. While the suit was pending he assigned the claim in separate parts to various persons, agreeing to continue the prosecution of the suit in his own name and to account for the proceeds. More than four months thereafter, while the suit was still pending, he filed a voluntary petition in bankruptcy. He did not mention the suit in question in his schedules. No assets were disclosed; no trustee was appointed; and the bankrupt was discharged.

At the trial of the case in the State Court the defendants took the position that by reason of the pendency of

the bankruptcy proceeding, Smith's right to proceed in the State Court terminated. This contention was overruled in the State Court, and is the subject-matter of the decision of the Supreme Court of the United States.

The decision of the State Court was sustained on the ground that the bankrupt's title to a right of action was not under the above-stated facts divested by the proceeding in bankruptcy.

It will be perceived, however, that the crux of this case was that the bankrupt had divested himself of the ownership of the claim in question **prior** to the filing of his petition in bankruptcy. The ruling made in the *Lasater case, supra,* is stated by the Court in its opinion, and that case is distinguished on the ground that there a trustee had been appointed to whom the right of action involved in the State Court proceeding had passed. In the *Lasater case,* of course, the disclosure of the claim would have been immaterial, as far as the appointment of a trustee is concerned, because the claim had been assigned. In the present case a trustee has been appointed and not only has the claim not been assigned, but it is a claim of so substantial a character as would materially affect the rights of all of the creditors of the bankrupt, as well as of the bankrupt himself.

So too as to cases like that of *Johnson v. Collier,* 222 U. S., 538, 56 L. Ed., 306, likewise cited by petitioners. All that this case holds is that where a bankrupt, before the filing of his voluntary petition, had brought a suit for damages in a State Court, the prosecution of this suit in the State Court in the name of the bankrupt is permissible, so long as the trustee does not act, subject to the rule that any recovery obtained in the State Court suit would enure to the benefit of the bankrupt estate. The trustee in that case had taken no action in the matter.

As distinguished from the situation in the two cases last above referred to, here we have a trustee in bankruptcy duly appointed, directed by the Court which appointed him to pursue the claims in question in an appropriate proceeding in the bankruptcy Court, and by that means rectify the situation that had been created by the fraud of the bankrupt in obtaining his discharge, without a disclosure of the existence of the asset, and in procuring the termination of the bankruptcy proceeding without a trustee being appointed.

Unlike those cases, the present case does not involve the question whether, if the trustee in this case had failed to take any interest in the situation in the Lee County Court, the defendants could have successfully maintained their defense that by reason of the bankruptcy proceeding, and the fraud of the bankrupt connected therewith, the action in the State Court was not maintainable.

The elements of the question now under discussion having however been so fully covered in the order of the District Judge dated September 1, 1938, it would be merely repetition to cite and discuss the authorities here. Reference is made to that order (pp. 87 *et seq.*).

The statement in the brief of petitioner (p. 11) that "they (the McLendons) first submitted to the jurisdiction of the state court by answering therein", is misleading. The implications of that statement are contrary to the facts. The Circuit Court of Appeals had before it the answer interposed by the McLendons in the state court, since under the rules of said Court all of the pleadings in the case go up to the Court, whether they are printed in the record or not (Rule 10), and that answer has been before this Court also, as will be seen from the transcript of record on a prior petition for a writ of certiorari at an earlier stage of the present cause (see Transcript of Record No. 958, October

term, 1938, pp. 20 *et seq.*). In the sixth defense of the two defendants principally concerned in the case (p. 23 of record above referred to) the bankruptcy proceedings were specifically adverted to and allegations are made that the Trustee alone had title to the lands and moneys involved in the present litigation; that he is the real party in interest; and that he alone has the right to maintain the action.

And in the seventh defense in the same answer (*Ibid.*) it is set forth that by reason of Lane's bankruptcy proceedings, and of his withholding of the property and rights of action in question in scheduling his assets in bankruptcy, he is estopped from proceeding in the state court suit, and the judgment of the bankruptcy court is pleaded as a bar to the maintenance of the action.

It will be recalled that the suit in the state court was instituted just five months after Lane had obtained his discharge in bankruptcy; that at the time of the institution of the suit the bankruptcy proceedings had been concluded, without the appointment of a trustee, and that the proceedings to reopen the bankruptcy cause had not been begun.

Under these circumstances, as has been held by this Court (*Danzinger v. Smith, supra*), Lane had the technical right to institute his action in the state court in his own name, subject of course to whatever action might be taken in connection with the bankruptcy proceedings.

It was indispensable that the McLendons answer in the state court. Had they failed to do so, judgment by default would have been entered against them. But they promptly proceeded to have the bankruptcy proceeding reopened, the discharge vacated, and a trustee appointed, as hereinbefore shown.

The exclusiveness of the jurisdiction of the bankruptcy court following the submission by the respondents to that jurisdiction, notwithstanding anything that may have tran-

spired in the state court, is clearly indicated by the case of *United States Fidelity and Guaranty Company v. Bray*, 225 U. S., 205, 56 L. Ed., 1055, where this Court said:

> "We think it is a necessary conclusion from these and other provisions of the act that the jurisdiction of the bankruptcy courts in all 'proceedings in bankruptcy' is intended to be exclusive of all other courts, and that such proceedings include, among others, all matters of administration, such as the allowance, rejection, and reconsideration of claims, the reduction of the estates to money, and its distribution, the determination of the preferences and priorities to be accorded to claims presented for allowance and payment in regular course, and the supervision and control of the trustees and others who are employed to assist them.
>
> * * *
>
> "A distinct purpose of the bankruptcy act is to subject the administration of the estates of bankrupts to the control of tribunals clothed with authority and charged with the duty of proceeding to final settlement and distribution in a summary way, as are the courts of bankruptcy. Creditors are entitled to have this authority exercised, and justly may complain when, as here, an important part of the administration is sought to be effected through the slower and less appropriate processes of a plenary suit in equity in another court, involving collateral and extraneous matters with which they have no concern, such as the controversy between the complainanant and the indemnitor banks.
>
> "Of the fact that the suit was begun in the circuit court with the express leave of the court of bankruptcy, it suffices to say that the latter was not at liberty to surrender its exclusive control over matters of administration, or to confide them to another tribunal."

In the case of *Isaacs v. Hobbs Tie & Timber Co.*, 282 U. S., 734, 75 L. Ed., 645, this Court said:

> "The jurisdiction in bankruptcy is made exclusive in the interest of the due administration of the estate

and preservation of the rights of both secured and unsecured creditors. This fact places it beyond the power of the court's officers to oust it by surrender of property which has come into its possession."

Respectfully submitted,

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(17)

Supreme Court of the United States

OCTOBER TERM, 1943

No. 830

MELVIN HYMAN, AS TRUSTEE IN BANKRUPTCY OF JOSEPH BENJAMIN LANE, AND JOSEPH BENJAMIN LANE, PETITIONERS.

versus

R. W. McLENDON, W. E. McLENDON AND C. E. McLENDON, RESPONDENTS.

PETITIONERS' POINTS AND AUTHORITIES IN REPLY

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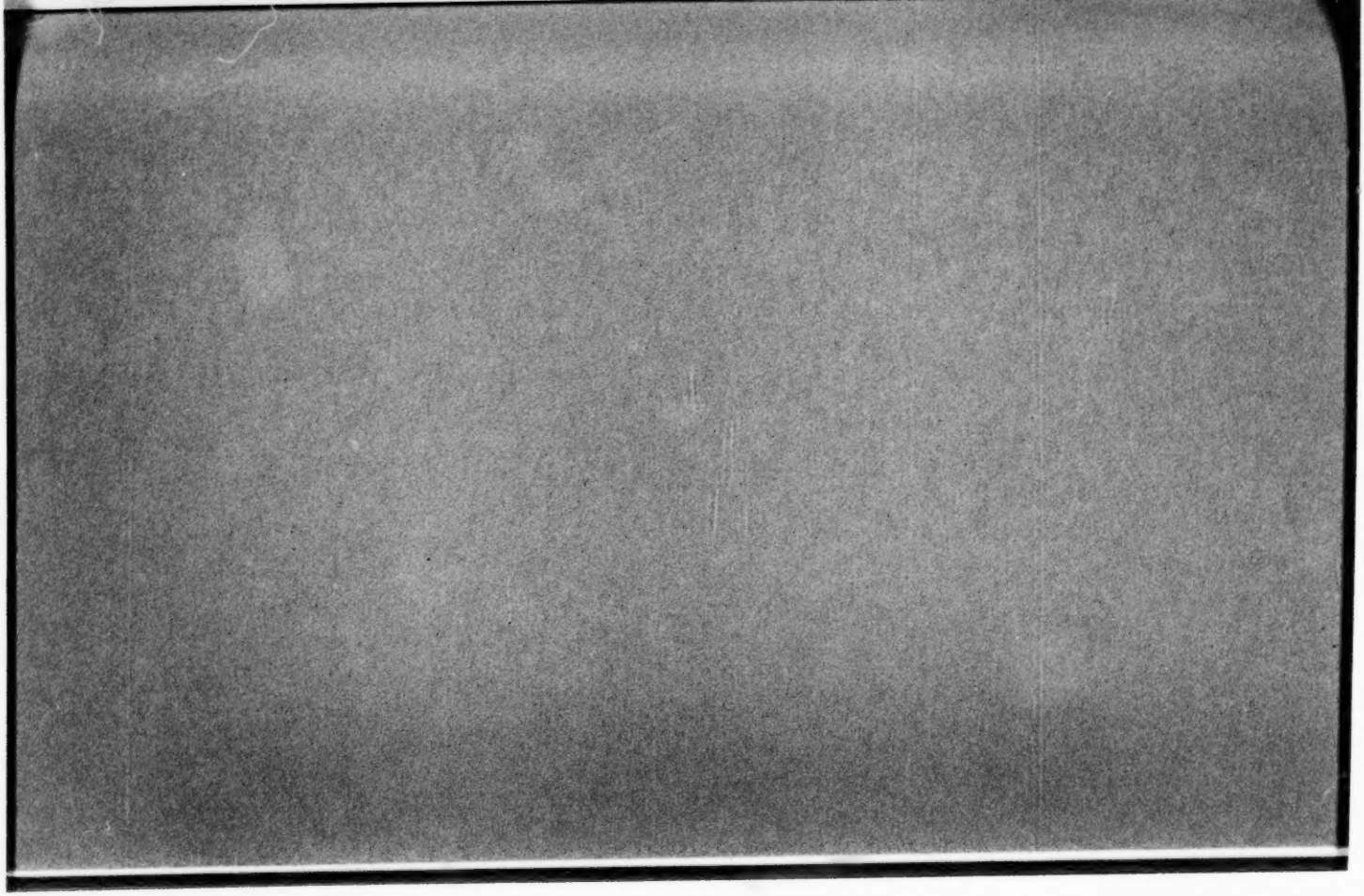

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POINTS AND AUTHORITIES IN REPLY

Although the sole question presented to this Court is that of jurisdiction, the respondents (McLendons) in their "Reply Brief" start out by trying to muddle in, according to their first topic, "THE FACTS" on a very incomplete and imperfect record, making inferences and innuendos, to accept which the Court will be forced to go outside of the record.

They pose the specious but unsound proposition that if the jurisdictional objection is sustained by this Court, the Trustee would have to proceed with litigation in the state court in the face of a "final ruling" in the federal court that neither he nor the bankrupt has any rights in the premises. The answer is this:—

> "Where the Court below has no jurisdiction of the case in any form of proceeding, this court will, if judgment is for the defendant or respondent, direct the cause to be dismissed; if for the plaintiff or peti-

> tioner, it will reverse the judgment or decree, and remand the cause, with directions to dismiss the suit."
>
> *Stickney v. Wilt*, 23 Wall. 150, 23 L. Ed. 50.

The petition of the McLendons, beginning at page 20 of the record will, if the jurisdiction objection be sustained, be no doubt disposed of in accordance with the foregoing, and the above mentioned so-called "final ruling" treated as a nullity, in no sense binding on the state court or any other court.

Counsel's position that the facts of this case have become moot on the theory that the McLendons have bought up the judgments against Dr. Lane does not fairly present the case and is not supported by the record. The only thing that we know of in the record that tends to support any such proposition is the quotation in the respondents' brief from the U. S. Circuit Court of Appeals to the effect that, *as they understand from the argument*, the greater portion of the debts listed by the bankrupt are owing to the McLendons or to corporations owned or controlled by them. This must have come from something said in oral arguments by counsel for the McLendons; because the petitioners are not informed other than by such hearsay statements of any such status; and we are unaware of anything in our printed briefs that justifies any such conclusion by the court. The Special Master's Report at page 57 of this record shows that the debts of Dr. Lane amount to only $24,045.63 of which $19,270.81 were judgments. On the other hand, as shown by the complaint, the demands involved in this case reach considerably upwards of $85,000.00. If the McLendons owned the judgments, then clearly they do not own the entire estate. In fact, we doubt if Dr. Lane is really a bankrupt; because if he is not entitled to the relief sought he stands discharged as a bankrupt; and, if he is entitled to the relief sought, then he has vastly more than enough to pay his debts.

It is true that the special referee indulged in the remarkable view that Dr. Lane was estopped, while his trustee

in bankruptcy could proceed to enforce his claim; but we can not see how this can be reconciled with the principle that a trustee acquires no greater rights than the bankrupt had.

York Manufacturing Company vs. Cassell, 205, U. S. 344, 50 L. Ed. 782-785, 20 Sup. Ct. 481.

Hewit vs. Berlin Machinery Works, 194 U. S. 296, 48 L. Ed. 986, 24 Sup. Ct. 690.

Thompson vs. Fairbanks, 196 U. S. 516, 49 L. Ed. 577, 25 Sup. Ct. 306.

In Re: K. T. Sandwich Shoppe of Akron, Inc. 34 F. (2d) 962.

Indeed, it seems to us shocking to contemplate even the idea that if Dr. Lane has been defrauded by the McLendons out of more than $85,000.00 in money and property, as he stoutly maintains, that simply because he owes some $21,000.00 of that amount, those who defrauded him should be allowed to keep the remaining $61,000.00 or more on the sophistical grounds advanced in this case.

Further discussion of this subject would lead us into the merits of this case in a very incomplete, one-sided, and unfair state of the record. If this Honorable Court will order before it the entire record in some way that Dr. Lane can finance, we shall be only too glad to meet issues like this; but, as we are merely presenting the jurisdictional question, we feel that the effect of counsel's argument is to stray far beyond the scope of the record that is being presented to this Honorable Court.

To hold that the Trustee has the right to recover from the McLendons, if it is shown that they are due Dr. Lane anything, sufficient funds to pay his creditors, but that Dr. Lane is estopped from getting back from them the difference between what is due the creditors and what they have of his, would be, it seems to us, putting the stamp of approval upon an attorney's obtaining, while he bore the confidential relationship to his client, large sums of money and title to property, under the guise of obtaining

this to pay the creditors and save the property for the client; and then because the client may have been derelict or negligent in taking steps sooner to recover the property, that he is now estopped from doing so, and that the party who thus defrauded him may keep it. We cannot conceive of a court of equity putting its stamp of approval on any such dealings.

JURISDICTION OF BANKRUPTCY COURT

It seems rather inconsistent to us to find counsel exerting a great effort to becloud the question of jurisdiction by intimating through their argument, without openly saying it, that this proceeding is plenary instead of summary.

This is totally inconsistent with their position on the former appeal. There, as the basis for dismissing our appeal because of not having been brought within thirty days, the Circuit Court of Appeals very plainly stated that the position that this was a plenary suit could not be sustained (102 F. (2nd), 189, 190).

As stated in brief subjoined to the petition to the U. S. Supreme Court we make no question about a trustee in Bankruptcy as an officer of the court being subject to its control; but we question the power of the court to think and act for the trustee and to make him a perfect automatom and to leave him without any independence of conduct in the matter of giving or withholding his consent to the jurisdiction of any court, which choice the statute confers upon him. We respectfully submit that counsel's innuendo about this litigation constituting the grossest kind of mockery and indeed definance of the bankruptcy court, etc. is entirely out of place, unsupported by the record, improper, and, "shows a comparable attitude of cynicism and indifference" (to quote from them) in trying to prejudice an august tribunal like the U. S. Supreme Court from passing on the fair interpretation of a plain Act of Congress in relation to jurisdiction!

Since brevity is a prime consideration in the preparation of this reply, we will prolong it no further than to point out the length to which counsel have gone in their effort to defeat a hearing of this case by this Honorable Court by citing authorities that are totally out of point, to wit:—

On page 17 of their brief, respondents contend that the right to have a controversy involving the adverse claimant or his property determined by the Federal Court of Bankruptcy is a privilege that belongs to such claimant alone, and if he sees fit to submit himself and his rights to the jurisdiction of the Federal Court and ask such Court to adjudicate all controversies between him and the bankrupt, or the trustee in bankruptcy, neither of these can raise the slightest objection. And they cite cases.

The first of these cases is *United States Fidelity & Guaranty Co. vs. Bray*, 225 U. S. 205, 56 L. Ed. 1055. Now, that case was not one, like the case at bar, where the Trustee and the Bankrupt are suing the adverse claimant to recover the money and the property but affected a fund of $26,000.00 in the hands of the trustee in bankruptcy then in the course of administration. The United States Supreme Court itself clearly distinguishes that case from cases like the one at bar in the following quotation from the decision, to wit:—

> (225 U. S. 216; 56 L. Ed. 1061, 1062): "We are not here concerned with a suit by a trustee to recover property in the possession of another who claims it adversely, nor with a suit against a trustee to recover property in his possession claimed by another, and therefore the jurisdictional questions incident to suits of that character need not be considered. But we are concerned with a suit against a trustee, the purpose of which is to control the distribution of a fund in his possession, admittedly belonging to the bankrupt's estate, and to determine to what extent and in what order the several creditors shall participate therein."

And the *Bray Case*, moreover, serves only to bolster the Petitioners proposition (page 23 of their brief) that "the Court that is first in time is first in right". In this case, the State Court was distinctly first in time, and hence was first in right.

The case of *Schumacher vs. Beeler*, 293 U. S. 367, 79 L. Ed. 433, was originally brought by the trustee in the Federal Court and the other party consented for all matters to be heard in the Federal Court, and the Supreme Court pointed out that the purpose of the bankrutcy act was to leave controversies with adverse claimants to be heard and determine for the most part in the state courts. The case does not in any sense support the interpretation placed upon it by counsel for the respondents here.

In like manner *Re*: *Hollingsworth & Whitney Co.*, 242 Fed., 753 (C. C. A., 1st) had in it nothing that resembles the question now at bar. In that case the trustee was already in the bankruptcy court and was not contesting its jurisdiction.

Peoples National Bank vs. Green, 296 Fed. 294 (C. C. A. 4th) is irrelevant to the present question; because no issue was made by the trustee as to the jurisdiction of the bankruptcy court.

Re: *Bennett*, 285 Fed. 351 (C. C. A. 7th) was a case in which the adverse party objected to the federal jurisdiction, and the trustee sought to maintain it. The case was remanded to the state court; which demonstrates, exactly to the opposite of what the respondents McLendon are contending for here, that the lack of consent of *one* of the contesting parties to the federal jurisdiction defeats it.

Indeed, on account of the fact that the trustee, Melvin Hyman, resorted to the state court in the first instance for the prosecution of this claim, the State Court had full

control over the litigation. *Brown vs. Gerdes,* 64 Sup. Court 487 (decided Feb. 7th, 1944).

Respectfully submitted,

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